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SECURITIES AND EXCHANGE COMMISSION  
 Washington, D.C. 20549

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 1992

**FORM 10-Q**

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ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)  
 OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarter Ended March 31, 1992

Commission File Number: 0-3676

**VSE CORPORATION**  
 (Exact Name of Registrant as Specified in Its Charter)

DELAWARE  
 (State or Other Jurisdiction of  
 Incorporation or Organization)

54-0649263  
 (I.R.S. Employer  
 Identification No.)

2550 Huntington Avenue  
 Alexandria, Virginia  
 (Address of Principal Executive Offices)

22303-1499  
 (Zip Code)

Registrant's Telephone Number, Including Area Code

(703) 960-4600

Securities registered pursuant to  
 Section 12(b) of the Act:

None

Securities registered pursuant to  
 Section 12(g) of the Act:

Common Stock, par value \$.05 per share  
 (Title of Class)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Number of shares of Common Stock outstanding on May 1, 1992: 1,671,816 shares.

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**VSE CORPORATION AND SUBSIDIARIES**  
**Consolidated Financial Statements (Unaudited)**

|                                                                   | March 31, 1992   | December 31, 1991 |
|-------------------------------------------------------------------|------------------|-------------------|
| <b>Consolidated Balance Sheets</b>                                |                  |                   |
| (in thousands, except share amounts)                              |                  |                   |
| <b>Assets</b>                                                     |                  |                   |
| <b>Current assets:</b>                                            |                  |                   |
| Cash and cash equivalents (Note 1)                                | \$ 249           | \$ 190            |
| Accounts receivable, principally                                  |                  |                   |
| U. S. Government (Notes 1, 3 and 6)                               | 15,879           | 13,136            |
| Deferred tax charges (Notes 1 and 9)                              | 2,159            | 1,870             |
| Other current assets                                              | 1,341            | 1,135             |
| Net assets held for sale (Note 2)                                 | -0-              | 6,096             |
| Net current assets of discontinued operations (Note 2)            | 5,173            | -0-               |
| <b>Total current assets</b>                                       | <b>24,801</b>    | <b>22,427</b>     |
| Property and equipment, net (Notes 1 and 6)                       | 4,013            | 3,801             |
| Other assets                                                      | 1,512            | 1,501             |
| Net property, equipment, and other noncurrent assets              |                  |                   |
| of discontinued operations (Note 2)                               | 6,597            | 6,597             |
| <b>Total assets</b>                                               | <b>\$ 36,923</b> | <b>\$ 34,326</b>  |
| <b>Liabilities and Stockholders' Investment</b>                   |                  |                   |
| <b>Current liabilities:</b>                                       |                  |                   |
| Current portion of long-term debt (Note 6)                        | \$ 23            | \$ 23             |
| Accounts payable and other current liabilities                    | 5,247            | 2,562             |
| Accrued expenses (Note 7)                                         | 6,087            | 5,171             |
| Accrued income taxes (Notes 1 and 9)                              | -0-              | 70                |
| Dividends payable                                                 | 117              | 118               |
| Net current liabilities of discontinued operations (Note 2)       | -0-              | 923               |
| <b>Total current liabilities</b>                                  | <b>11,474</b>    | <b>8,877</b>      |
| Long-term debt, less current portion above (Note 6)               | 2,705            | 2,794             |
| Deferred compensation                                             | 1,033            | 995               |
| Deferred income taxes (Notes 1 and 9)                             | 36               | 71                |
| <b>Total liabilities</b>                                          | <b>15,248</b>    | <b>12,777</b>     |
| <b>Commitments and contingencies (Notes 1 and 10)</b>             |                  |                   |
| <b>Stockholders' investment:</b>                                  |                  |                   |
| Common stock, par value \$.05 per share, authorized 5,000,000     |                  |                   |
| shares in 1992 and 1991; issued 1,948,044 shares in 1992 and 1991 | 97               | 97                |
| Paid-in surplus                                                   | 8,247            | 8,247             |
| Retained earnings                                                 | 15,902           | 15,826            |
| Treasury stock, at cost (276,228 shares in 1992 and 1991)         | (2,571)          | (2,571)           |
| <b>Total stockholders' investment</b>                             | <b>21,675</b>    | <b>21,599</b>     |
| <b>Total liabilities and stockholders' investment</b>             | <b>\$ 36,923</b> | <b>\$ 34,326</b>  |

See accompanying notes

VSE CORPORATION AND SUBSIDIARIES  
Consolidated Financial Statements (Unaudited)

For the three months ended March 31,

| Consolidated Statements of Income<br>(in thousands, except per share data)                                            | 1992          | 1991          |
|-----------------------------------------------------------------------------------------------------------------------|---------------|---------------|
| Revenues, principally from contracts (Note 1) .....                                                                   | \$ 19,457     | \$ 16,541     |
| Costs and expenses of contracts (Notes 1, 8, 10) .....                                                                | <u>18,518</u> | <u>15,941</u> |
| Gross profit .....                                                                                                    | 939           | 600           |
| Selling, general and administrative expenses (Notes 1, 4, 10) .....                                                   | 595           | 548           |
| Interest expense .....                                                                                                | <u>35</u>     | <u>156</u>    |
| Income (loss) from continuing operations, before income taxes .....                                                   | 289           | (104)         |
| Provision (benefit) for income taxes (Notes 1 and 9) .....                                                            | <u>97</u>     | <u>(41)</u>   |
| Income (loss) from continuing operations .....                                                                        | 192           | (63)          |
| Income from discontinued operations, less applicable<br>income taxes of \$-0- in 1992 and \$40 in 1991 (Note 2) ..... | <u>-0-</u>    | <u>123</u>    |
| Net income .....                                                                                                      | <u>\$ 192</u> | <u>\$ 60</u>  |
| Earnings per common share, based on weighted average shares<br>outstanding (1,671,816 in 1992 and 1,682,829 in 1991): |               |               |
| Income (loss) from continuing operations .....                                                                        | \$ .11        | \$ (.03)      |
| Income from discontinued operations .....                                                                             | <u>-0-</u>    | <u>.07</u>    |
| Net income .....                                                                                                      | <u>\$ .11</u> | <u>\$ .04</u> |

Consolidated Statements of Stockholders' Investment  
(in thousands)

|                                  | Common Stock     |              | Paid-In         | Retained         | Treasury          |
|----------------------------------|------------------|--------------|-----------------|------------------|-------------------|
|                                  | Shares<br>Issued | Dollars      | Surplus         | Earnings         | Stock<br>Dollars  |
| Balance at December 31, 1990 ..  | 1,948            | \$ 97        | \$ 8,247        | \$ 20,975        | \$ (2,503)        |
| Net income for the period .....  | -                | -            | -               | 60               | -                 |
| Dividends declared (\$.07) ..... | -                | -            | -               | (117)            | -                 |
| Purchase of Treasury stock ..... | -                | -            | -               | -                | <u>(7)</u>        |
| Balance at March 31, 1991 .....  | <u>1,948</u>     | <u>\$ 97</u> | <u>\$ 8,247</u> | <u>\$ 20,918</u> | <u>\$ (2,510)</u> |
| Balance at December 31, 1991 ..  | 1,948            | \$ 97        | \$ 8,247        | \$ 15,826        | \$ (2,571)        |
| Net income for the period .....  | -                | -            | -               | 192              | -                 |
| Dividends declared (\$.07) ..... | -                | -            | -               | (116)            | -                 |
| Purchase of Treasury stock ..... | -                | -            | -               | -                | -                 |
| Balance at March 31, 1992 .....  | <u>1,948</u>     | <u>\$ 97</u> | <u>\$ 8,247</u> | <u>\$ 15,902</u> | <u>\$ (2,571)</u> |

See accompanying notes

**VSE CORPORATION AND SUBSIDIARIES**  
**Consolidated Financial Statements (Unaudited)**

For the three months ended March 31,  
1992 1991

**Consolidated Statements of Cash Flows**  
(in thousands)

|                                                                                       |         |         |
|---------------------------------------------------------------------------------------|---------|---------|
| <b>Cash flows from operating activities:</b>                                          |         |         |
| Net income .....                                                                      | \$ 192  | \$ 60   |
| Adjustments to reconcile net income to net cash<br>provided by continuing operations: |         |         |
| Depreciation and amortization .....                                                   | 301     | 375     |
| (Income) loss from discontinued operations .....                                      | -0-     | (123)   |
| Loss on sale of property and equipment .....                                          | 11      | 18      |
| Deferred compensation plan expense .....                                              | 37      | 18      |
| Change in assets and liabilities                                                      |         |         |
| (Increase) decrease in:                                                               |         |         |
| Accounts receivable .....                                                             | (2,743) | 4,858   |
| Other current assets .....                                                            | (206)   | (147)   |
| Deferred tax charges .....                                                            | (289)   | (212)   |
| Other assets .....                                                                    | (29)    | 14      |
| Increase (decrease) in:                                                               |         |         |
| Accounts payable and other current liabilities .....                                  | 2,693   | 47      |
| Accrued expenses .....                                                                | 916     | 109     |
| Accrued and deferred taxes .....                                                      | (70)    | (567)   |
| Deferred taxes - noncurrent .....                                                     | (35)    | -0-     |
| Net cash provided by continuing operations .....                                      | 778     | 4,450   |
| Net cash provided by (used in)                                                        |         |         |
| discontinued operations .....                                                         | -0-     | 123     |
| Net cash provided by operations .....                                                 | 778     | 4,573   |
| <b>Cash flows from investing activities:</b>                                          |         |         |
| Purchase of property and equipment .....                                              | (543)   | (174)   |
| Proceeds from disposition of property and equipment .....                             | 37      | 12      |
| Change in net assets of discontinued operations .....                                 | -0-     | (271)   |
| Net cash provided by (used in) investing activities .....                             | (506)   | (433)   |
| <b>Cash flows from financing activities:</b>                                          |         |         |
| Additions to (repayments of) bank notes payable .....                                 | -0-     | (9,367) |
| Proceeds from deferred compensation .....                                             | 3       | 8       |
| Proceeds from long-term debt .....                                                    | -0-     | 5,623   |
| Purchase of Treasury stock .....                                                      | -0-     | (7)     |
| Cash dividends paid .....                                                             | (116)   | (117)   |
| Payments of deferred compensation .....                                               | (11)    | (23)    |
| Payment of long-term debt .....                                                       | (89)    | (3)     |
| Net cash (used in) financing activities .....                                         | (213)   | (3,886) |
| Net increase in cash and cash equivalents .....                                       | 59      | 254     |
| Cash and cash equivalents at beginning of year .....                                  | 190     | 532     |
| Cash and cash equivalents at end of period .....                                      | \$ 249  | \$ 786  |

See accompanying notes

VSE CORPORATION AND SUBSIDIARIES  
Notes to Consolidated Financial Statements

(1) Summary of Significant Accounting Policies

*Principles of Consolidation*

The consolidated financial statements include VSE Corporation ("VSE" or the "company") and its wholly owned subsidiaries Schmoldt Engineering Services Company ("Schmoldt Engineering"), VSE Corona, Inc. ("VCI"), VSE Services Corporation ("VSES"), and the operations of Human Resource Systems, Inc. ("HRSI"). All significant intercompany transactions have been eliminated in consolidation. Certain operations of the company have been presented as discontinued operations (see Note 2).

*Changes in Presentation*

Certain amounts related to 1991 included in the consolidated financial statements and related notes have been reclassified to conform to the 1992 presentation (see Note 2).

*Consolidated Statements of Cash Flows*

The company considers investments with an original maturity of three months or less to be cash equivalents. Supplemental disclosures of cash flow information and noncash financing activities for the three months ended March 31, 1992 and 1991, are presented below (in thousands):

|                                                      | <u>1992</u> | <u>1991</u> |
|------------------------------------------------------|-------------|-------------|
| Interest payments (net of amounts capitalized) ..... | \$ 12       | \$ 154      |
| Income tax payments .....                            | 325         | 443         |

*Contract Revenues*

Revenues on fixed-price contracts are recorded using the percentage-of-completion method. During the performance of such contracts, contract prices and estimated costs are reviewed and revisions are made as required. The effects of these revisions are included in the periods in which such revisions are made. Revenues on cost-type contracts are recorded on the basis of recoverable costs incurred and fees earned. Losses on contracts are recognized when they become known.

A substantial portion of the contract and administrative costs is subject to audit by the Defense Contract Audit Agency. The company's indirect cost rates have been audited and approved for 1988 and prior years. In the opinion of management, the reviews of 1989 through 1992 will not result in adjustments, if any, having a material adverse effect on the accompanying consolidated financial statements.

*Income Taxes*

The provision for income taxes is based on revenues and expenses reported for financial statement purposes rather than those amounts currently taxable. Deferred income taxes and deferred charges result from timing differences in reporting revenues and expenses for financial statement purposes and for income tax purposes.

The Financial Accounting Standards Board has issued SFAS No. 109, "Accounting for Income Taxes," which superseded APB Opinion No. 11 and SFAS No. 96. SFAS No. 109 differs from APB No. 11 primarily by requiring an asset and liability approach for financial accounting and reporting purposes. SFAS No. 109 requires implementation by the company in fiscal year 1993 and may be adopted by reporting a cumulative catch-up adjustment in the year of adoption or by restating prior year amounts. The company has not established the method or timing of implementation. However, the company does not believe that SFAS No. 109 will have a material adverse impact on the company's results of operations or financial position.

**VSE CORPORATION AND SUBSIDIARIES**  
**Notes to Consolidated Financial Statements**

*Property and Equipment*

A major portion of the property and equipment is pledged to secure the revolving term debt. Property and equipment (valued at cost) as of March 31, 1992, and December 31, 1991, are as follows (in thousands):

|                                                 | 1992            | 1991            |
|-------------------------------------------------|-----------------|-----------------|
| Land and land improvements .....                | \$ 348          | \$ 348          |
| Buildings .....                                 | 442             | 442             |
| Computer systems equipment .....                | 6,504           | 6,183           |
| Furniture, fixtures, equipment, and other ..... | 5,353           | 5,251           |
|                                                 | 12,647          | 12,224          |
| Less: Accumulated depreciation.....             | (8,634)         | (8,423)         |
|                                                 | <u>\$ 4,013</u> | <u>\$ 3,801</u> |

Depreciation and amortization expense for the three months ended March 31, 1992 and 1991, was approximately \$283 thousand and \$347 thousand, respectively. Depreciation of buildings and land improvements is provided principally by the straight-line method over approximately thirty years. Depreciation of furniture and fixtures is provided principally by the straight-line method over approximately nine years. Depreciation of all other property and equipment is provided principally by the double-declining balance method over periods of three to twenty years.

**(2) Discontinued Operations**

*Exchange Agreement*

On March 25, 1992, VSE entered into an agreement (the "Exchange Agreement") under which VSE will transfer to J. B. Toomey and his family (the "Exchanging Stockholders") all of the outstanding capital stock of VSE's subsidiaries Design and Production Incorporated ("D&P"), Starr Management Corporation ("Starr"), and Metropolitan Capital Corporation ("MetCap") in exchange for an aggregate of 808,649 shares of VSE common stock. The Exchange Agreement provides, among other things, for transfer to VSE of certain assets of Starr, including Starr's investment in HRSL, approximately 32 acres of Starr's improved real estate used by VSE as an engineering test center, and for the transfer to VSE of \$2.0 million in cash, or at VSE's option, by offset of VSE indebtedness, if any, to D&P and Starr. The Exchange Agreement is subject to certain contingencies including the approval of VSE stockholders at the annual meeting of stockholders expected to be held in July 1992. It is anticipated that closing on the Exchange Agreement will occur prior to September 1, 1992, following satisfaction of the conditions to the closing.

The company believes that the fair market value of the VSE common stock transferred from the Exchanging Stockholders to VSE is approximately equal to the fair market value of the D&P, Starr, and MetCap common stock transferred by VSE to the Exchanging Stockholders. The fair market value of the assets being transferred and the assets being received by the company are supported by an opinion received from a financial advisory firm. VSE and the Exchanging Stockholders will bear their own costs for the transaction.

As of March 25, 1992 (the measurement date), it is expected that the exchange transaction will result in a book gain to VSE of approximately \$1.5 million based on current estimates of the net realizable values of the discontinued operations at that date, after giving consideration to costs and expenses of approximately \$400 thousand directly associated with the disposal, and including expected losses, if any, of the discontinued operations through September 1, 1992, the anticipated disposal date.

Any gain on the sale of discontinued operations will be recognized when realized, which is ordinarily on the disposal date. The VSE shares received from the Exchanging Stockholders will be accounted for as Treasury shares.

**VSE CORPORATION AND SUBSIDIARIES**  
**Notes to Consolidated Financial Statements**

In connection with the Exchange Agreement, VSE obtained appraisals of the company's real estate. The appraisals were prepared on an "as-is" basis since the assets were not to be held for the long term. The appraisals of the real estate owned by Starr generally resulted in fair market values which are significantly less than the carrying value at which these properties were recorded on Starr's books, and a write-down of approximately \$4.4 million was recorded as of December 31, 1991.

The results of operations from activities related to the engineering services segment have been classified as income (loss) from continuing operations.

*Discontinued Operations*

The results of operations of D&P, MetCap, and Starr (excluding HRSI and certain other assets of Starr) were reclassified as discontinued operations as of December 31, 1991. Estimated net income for discontinued operations during 1992, which will be adjusted to actual amounts at the disposal date, are included in the estimated book gain discussed above (see "Exchange Agreement"). Amounts related to discontinued operations for the three months ended March 31, 1991, are summarized as follows (in thousands):

|                                         | 1991          |
|-----------------------------------------|---------------|
| Revenues .....                          | \$ 3,329      |
| Contract and administrative costs ..... | <u>3,166</u>  |
| Income before income taxes .....        | 163           |
| Provision for income taxes .....        | <u>40</u>     |
| Net income .....                        | <u>\$ 123</u> |

The estimated net realizable value of the assets from discontinued operations are included in the consolidated balance sheets as of March 31, 1992, and December 31, 1991, in "Net current assets of discontinued operations," "Net current liabilities of discontinued operations," and "Net property, equipment, and other noncurrent assets of discontinued operations." The net assets from discontinued operations as of March 31, 1992, and December 31, 1991, are as follows (in thousands):

|                                                                                          | 1992            | 1991            |
|------------------------------------------------------------------------------------------|-----------------|-----------------|
| Cash .....                                                                               | \$ 4,500        | \$ 1,507        |
| Certificate of deposit .....                                                             | 154             | 154             |
| Accounts receivable .....                                                                | 6,758           | 4,287           |
| Marketable securities .....                                                              | 89              | 89              |
| Other current assets .....                                                               | 455             | 291             |
| Bank notes payable .....                                                                 | (363)           | (140)           |
| Accrued expenses .....                                                                   | (1,030)         | (897)           |
| Accounts payable and other liabilities .....                                             | (3,362)         | (4,186)         |
| Current portion of long-term debt .....                                                  | <u>(2,028)</u>  | <u>(2,028)</u>  |
| Net current assets (liabilities)<br>of discontinued operations .....                     | <u>\$ 5,173</u> | <u>\$ (923)</u> |
| Investments in small business concerns .....                                             | \$ 2,502        | \$ 2,287        |
| Property, equipment, and other assets, net .....                                         | 10,121          | 9,635           |
| Long-term debt and other liabilities .....                                               | <u>(6,026)</u>  | <u>(5,325)</u>  |
| Net property, equipment, and other noncurrent<br>assets of discontinued operations ..... | <u>\$ 6,597</u> | <u>\$ 6,597</u> |

As of March 31, 1992, and December 31, 1991, MetCap had debentures outstanding with the Small Business Administration ("SBA") of approximately \$2.0 million. On April 24, 1992, the SBA called the debentures as a result of MetCap's capital impairment. MetCap entered into a demand note with interest with Starr whereby MetCap could borrow up to \$2.3 million. MetCap repaid the SBA in full on April 27, 1992, and is currently withdrawing from the SBA program.

**VSE CORPORATION AND SUBSIDIARIES**  
**Notes to Consolidated Financial Statements**

*Assets Held for Sale*

The results of operations related to certain assets owned by Starr and used in the engineering services business, primarily the facility in Norco, California, were included in income (loss) from continuing operations. In December 1991 Starr wrote-down the cost of the Norco facility by approximately \$1.7 million to its estimated net realizable value as of December 31, 1991, and on February 28, 1992, Starr sold the Norco facility for an amount equal to the net realizable value. The estimated net realizable value of such assets is included in "Net assets held for sale" at December 31, 1991.

*Guarantees - Discontinued Operations*

The company is a guarantor of an Industrial Development Revenue Note assumed by Alexandria Tech Center II/Starr Associates, a Virginia general partnership of which Starr is a 50% partner. As of March 31, 1992, the outstanding principal of the note was approximately \$2.9 million. The note evidences loan proceeds that were used to finance the construction of an office building which was completed in 1987. The company leased 50% of the office building owned by the partnership for a period of ten years and the remaining 50% of the building for a period of five years. The five and ten year lease periods expire in July 1992 and July 1997, respectively.

The company is the guarantor of D&P's \$2.0 million line of credit with a bank. There are no borrowings outstanding under the D&P line as of March 31, 1992.

The company is a guarantor of performance bonds for D&P in the amount of \$6.7 million. Approximately \$900 thousand of the work covered by the performance bonds remains to be completed as of March 31, 1992.

Pursuant to the Exchange Agreement, D&P and Starr have agreed to seek releases of VSE, effective as of the closing of the Exchange Agreement or thereafter, from all guarantees given by VSE on behalf of D&P or Starr. If such releases cannot be obtained, D&P and Starr have agreed not to extend the duration or increase the amount of any VSE guarantees. In addition, D&P and Starr have agreed to indemnify the company for any guarantee given by VSE on behalf of D&P or Starr.

**(3) Accounts Receivable**

The components of accounts receivable as of March 31, 1992, and December 31, 1991, are as follows (in thousands):

|                                                                                             | 1992             | 1991             |
|---------------------------------------------------------------------------------------------|------------------|------------------|
| Billed .....                                                                                | \$ 8,327         | \$ 6,755         |
| Unbilled:                                                                                   |                  |                  |
| Retainages (generally not billable within one year) .....                                   | 414              | 480              |
| Other (principally March work billed in April<br>and December work billed in January) ..... | 7,423            | 6,165            |
| Less - Allowance for doubtful accounts .....                                                | (285)            | (264)            |
| Total accounts receivable .....                                                             | <u>\$ 15,879</u> | <u>\$ 13,136</u> |

Accounts receivable "Unbilled: Other" are reported net of an allowance for contract disallowances of approximately \$1.2 million as of March 31, 1992, and December 31, 1991. "Unbilled: Other" also includes certain costs which are not reimbursable under current contracts, but which the company believes will be reimbursable on execution of contract documentation or amendments increasing funding. Amounts not presently reimbursable included in "Unbilled: Other" were approximately \$182 thousand and \$124 thousand as of March 31, 1992, and December 31, 1991, respectively.

VSE CORPORATION AND SUBSIDIARIES  
Notes to Consolidated Financial Statements

Contracts with the U. S. Government accounted for approximately 94% and 95% of consolidated revenues in the three month periods ended March 31, 1992 and 1991, respectively. These contracts were performed primarily in the engineering services industry. One such contract with the U. S. Navy accounted for approximately 24% and 31% of consolidated revenues during the respective periods.

(4) Nonoperating Net Income

Nonoperating net income included in contract and administrative costs, primarily interest income, was approximately \$1 thousand and \$21 thousand for the three months ended March 31, 1992 and 1991, respectively.

(5) Schmoldt Engineering

In July 1990 the company acquired all of the outstanding stock of Schmoldt Engineering for cash and debt. The debt was paid in December 1990 and all obligations to the previous owner of Schmoldt Engineering were satisfied in full in 1991. The acquisition was accounted for by the purchase method of accounting. Goodwill of approximately \$95 thousand and intangible assets of approximately \$350 thousand are being amortized by the straight-line method over periods from one and a half to ten years.

(6) Debt

Long-term debt as of March 31, 1992, and December 31, 1991, was as follows (in thousands):

|                                                                            | 1992            | 1991            |
|----------------------------------------------------------------------------|-----------------|-----------------|
| Revolving term loans (interest at the bank's prime rate of interest) ..... | \$ 2,704        | \$ 2,792        |
| Other debt .....                                                           | 24              | 25              |
|                                                                            | 2,728           | 2,817           |
| Less portion due within one year .....                                     | (23)            | (23)            |
|                                                                            | <u>\$ 2,705</u> | <u>\$ 2,794</u> |

VSE and certain of its engineering services subsidiaries (the "Borrowers") have a term loan agreement (the "agreement") with a bank whereby the Borrowers may borrow up to \$8.0 million, subject to borrowing base formulas and certain other conditions. The loans and any interest thereon shall be payable on the termination date of May 31, 1993, which date may be extended at the option of the bank. Borrowings under this agreement are secured generally by all of the Borrowers' accounts receivable, equipment, and inventory.

Amounts borrowed under the agreement bear interest payable quarterly at the prime rate of interest established by the bank. The Borrowers are required to pay a quarterly commitment fee at the rate of 0.375% per annum on the average daily unused amount of the loan commitment. The agreement requires the company to maintain a minimum tangible net worth and leverage ratios, as defined in the agreement, of \$24.5 million and 1.5 to 1.0 until December 31, 1991, and \$25.0 million and 1.4 to 1.0 at all times thereafter, and limits the payment of cash dividends to an annual rate of up to \$.30 per share. The maturity of this debt could be accelerated if certain covenants in the agreement are not met.

Certain covenants of the agreement are required to be amended as a result of the Exchange Agreement (see Note 2). The company's bank has agreed to waive such covenants pending amendment of the agreement. The company was in compliance with all other covenants as of March 31, 1992, and December 31, 1991.

For consolidated cash management purposes, VSE has aggregate short-term borrowings from D&P and Starr of approximately \$2.5 million as of March 31, 1992.

(7) Accrued Expenses

The components of accrued expenses as of March 31, 1992, and December 31, 1991 are as follows (in thousands):

|                              | 1992            | 1991            |
|------------------------------|-----------------|-----------------|
| Accrued salaries .....       | \$ 1,950        | \$ 1,664        |
| Accrued vacation .....       | 1,438           | 1,249           |
| Other accrued expenses ..... | 2,699           | 2,258           |
|                              | <u>\$ 6,087</u> | <u>\$ 5,171</u> |

(8) Retirement Plans

VSE established an ESOP/401(k) plan in 1984. Under the provisions of the ESOP portion of the plan, the company and certain of its subsidiaries make contributions into a trust which purchases VSE stock on behalf of employees who meet certain age and service requirements and are employed at the end of the plan year. Contributions at the rate of up to 2% of eligible employee compensation may be made at the discretion of the board of directors and are allocated, subject to a vesting schedule, on a pro rata basis on eligible employee compensation. The 401(k) segment of the plan allows employees meeting certain age and service requirements to contribute a portion of their salary to certain investment trusts.

The retirement plan expense for VSE and certain of its subsidiaries under this plan for the three months ended March 31, 1992 and 1991, was approximately \$106 thousand and \$97 thousand, respectively. There are no prior service costs under the VSE retirement plan.

Schmoldt Engineering sponsors a qualified defined contribution profit sharing plan for employees who elect to become participants and who meet certain eligibility requirements. At its discretion, Schmoldt Engineering may contribute an amount of up to 15% of the participant's compensation to the plan. The Schmoldt Engineering plan expense for the three months ended March 31, 1992 and 1991, was approximately \$8 thousand and \$5 thousand, respectively.

In December 1990 the Financial Accounting Standards Board issued a new standard on accounting for post-retirement benefits other than pensions. The company does not offer post-retirement benefits to employees and has determined that the new accounting standard will have no effect on the company.

(9) Income Taxes

The company files consolidated Federal income tax returns with all of its subsidiaries. The differences between the amount of tax computed at the statutory Federal income tax rate of 34% and the provision (benefit) for income taxes for the three months ended March 31, 1992 and 1991, are as follows (in thousands):

|                                                | 1992         | 1991           |
|------------------------------------------------|--------------|----------------|
| Tax at statutory Federal income tax rate ..... | \$ 98        | \$ (35)        |
| Increases (Decreases) in tax resulting from:   |              |                |
| State taxes, net of Federal tax benefit .....  | 14           | (12)           |
| Other, net .....                               | (15)         | 6              |
| Income tax provision (benefit) .....           | <u>\$ 97</u> | <u>\$ (41)</u> |

(10) Commitments and Contingencies

*Leases*

The principal facilities of the company and its subsidiaries are generally rented under operating leases for periods of one to ten years. The company and its subsidiaries also lease equipment generally under noncancelable operating leases for periods of one to two years. Rent expense for the three months ended March 31, 1992 and 1991, was approximately \$1.0 million and \$1.2 million, respectively, which was net of sublease income of approximately \$50 thousand and \$37 thousand, respectively.

*Litigation*

The company has been notified by a bank that a civil action has been initiated by a third party against the bank with respect to a letter of credit issued by the bank pursuant to a standby letter of credit agreement between the bank and the company in favor of a third party. The letter of credit was issued to collateralize the third party's guarantee on behalf of the S. S. Monterey Limited Partnership passenger deposits. The third party has alleged that a draft of approximately \$300 thousand drawn on the letter of credit in 1991 was wrongfully dishonored by the bank and seeks payment of the draft and a judicial determination that the letter of credit is still outstanding. The bank has stated that it is looking to the company for indemnification of its legal fees and any adverse judgment. The company denies liability to the third party or the bank and intends to pursue its position vigorously if an adverse judgment is received by the bank.

The company and its subsidiaries have, in the normal course of business, certain other claims against them and against other parties. In the opinion of management, the resolution of these claims will not have a material adverse effect on the company's results of operations or financial position.

**VSE CORPORATION AND SUBSIDIARIES**  
**Management's Discussion and Analysis of**  
**Results of Operations and Financial Condition**

The following table sets forth the revenues and pretax income from continuing operations and other items of income (loss) and the amount of changes of such items for the three months ended March 31, 1992 and 1991 (in thousands). The results for the period ended March 31, 1991, have been reclassified to reflect continuing operations only.

|                                                         | 1992      | 1991      | 1992<br>Compared<br>to<br>1991 |
|---------------------------------------------------------|-----------|-----------|--------------------------------|
| Revenues from continuing operations .....               | \$ 19,457 | \$ 16,541 | \$ 2,916                       |
| Pretax income from continuing operations .....          | \$ 289    | \$ (104)  | \$ 393                         |
| Provision (benefit) for income taxes .....              | 97        | (41)      | 138                            |
| Income (loss) from continuing operations .....          | 192       | (63)      | 255                            |
| Income from discontinued operations, net of taxes ..... | -0-       | 123       | (123)                          |
| Net income .....                                        | \$ 192    | \$ 60     | \$ 132                         |

#### Results of Operations

Continuing operations includes the operations of VSE Corporation ("VSE" or the "company"), Human Resource Systems, Inc. ("HRSI"), Schmoldt Engineering Services Company ("Schmoldt Engineering"), VSE Corona, Inc. ("VCI"), and VSE Services Corporation ("VSES"), which operate principally in the engineering, development, testing, and management services industry. Intercompany sales are principally at cost.

The revenues from continuing operations increased for the three months ended March 31, 1992, compared to the same period of 1991 primarily due to new contracts awarded to VSE's Value Systems Services division and to HRSI. Other increases in revenues from continuing operations for this period in 1992 as compared to 1991 were due to an increase in VSE's engineering services volume.

Pretax income from continuing operations increased for the three months ended March 31, 1992, compared to the same period of 1991 primarily due to improved profit margins on existing VSE work. The improved VSE profit margins were attributable to reduced allocated general and administrative costs, improved contract cost management, and lower interest expense due to reduced borrowings and lower interest rates. Other increases in pretax income from continuing operations for this period in 1992 as compared to 1991 were due to a reduction in the expenses associated with the VCI subcontract termination and a reduction in costs associated with the start-up of HRSI.

#### Income Taxes

The Financial Accounting Standards Board has issued SFAS No. 109, "Accounting for Income Taxes," which superseded APB Opinion No. 11 and SFAS No. 96. SFAS No. 109 differs from APB No. 11 primarily by requiring an asset and liability approach for financial accounting and reporting purposes. SFAS No. 109 requires implementation by the company in fiscal year 1993 and may be adopted by reporting a cumulative catch-up adjustment in the year of adoption or by restating prior year amounts. The company has not established the method or timing of implementation. However, the company does not believe that SFAS No. 109 will have a material adverse impact on the company's results of operations or financial position.

### Discontinued Operations

On March 23, 1992, VSE's board of directors approved an exchange agreement under which VSE would transfer to the company's major stockholder, John B. Toomey, and his family, in exchange for their 808,649 shares (48.4%) of VSE common stock, VSE subsidiaries Design and Production Incorporated, Starr, and Metropolitan Capital Corporation. The proposed transaction is subject to, among other things, (a) an opinion from a financial consulting firm, which has not been withdrawn as of the closing date of the exchange, that the transaction is fair, from a financial point of view, to VSE's unaffiliated stockholders, and a ruling from the Internal Revenue Service that the transaction qualifies as a nontaxable corporate separation under the Internal Revenue Code, and (b) the approval of VSE's stockholders.

### Inflation and Pricing Policy

Most of the contracts performed by VSE provide for estimates of future labor costs to be escalated for any option periods provided by the contracts, while the non-labor costs included in such contracts are normally considered reimbursable at cost. VSE's property and equipment costs are not significant in the aggregate, and the overall impact of inflation on replacement costs is not significant.

### Liquidity and Capital Resources

During 1991 VSE, VCI, and Schmoldt Engineering (the "Borrowers") entered into a term loan agreement with a bank to finance up to \$8.0 million of operating cash requirements if needed. The loan agreement provides committed funds through May 1993 and is secured generally by all of the Borrowers' accounts receivable, equipment, and inventory. The financing available under the loan agreement is considered adequate to meet operating cash requirements for the foreseeable future.

**PART II. Other Information**

**Item 1. Legal Proceedings.**

Reference is made to Note 10 (Commitments and Contingencies) of "Notes to Consolidated Financial Statements" included in Part I of this Form 10-Q.

**Item 5. Other Information**

Reference is made to Note 2 (Discontinued Operations) of "Notes to Consolidated Financial Statements" included in Part I of this Form 10-Q on the repayment in April 1992 of certain debentures owed to the Small Business Administration by Metropolitan Capital Corporation.

**Item 6. Exhibits and Reports on Form 8-K.**

(a) Exhibits.

(11) Statement re computation of per share earnings. Reference is made to the "Consolidated Statements of Income" included in Part I of this Form 10-Q on the computation of per share earnings.

(b) Reports on Form 8-K.

On February 7, 1992, VSE Corporation (the "Registrant") filed a report on Form 8-K, reporting that the Registrant had signed a letter of intent representing an agreement in principle regarding the basic terms under which the Registrant will transfer to J. B. Toomey, and his family, all of the outstanding capital stock of the Registrant's subsidiaries Design and Production Incorporated, Starr Management Corporation, and Metropolitan Capital Corporation, in exchange for an aggregate of 808,649 shares of VSE common stock, par value \$.05 per share, held by J. B. Toomey, and his family. A copy of the Registrant's press release on this matter was filed as an exhibit to the Form 8-K, and a copy of the letter of intent signed by the Registrant and by J. B. Toomey and certain family members was also filed as an exhibit to the Form 8-K.

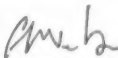
Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has omitted all other items contained in "Part II. Other Information" because such other items are not applicable or are not required if the answer is negative or because the information required to be reported therein has been previously reported.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

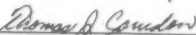
VSE CORPORATION

Date: May 15, 1992



C. S. Weber, Senior Vice President,  
Secretary and Treasurer  
(Principal Financial Officer)

Date: May 15, 1992



T. J. Corridon, Assistant Vice President  
and Director of Accounting  
(Principal Accounting Officer)

The financial information included in this report reflects all known adjustments normally determined or settled at year-end which are, in the opinion of management, necessary to a fair statement of the results for the interim periods. The accompanying notes to consolidated financial statements are an integral part of this report.